On August 3, 2009, the Indenture Trustee filed suit against the County, again seeking appointment of a receiver, in the Circuit Court of Jefferson County. Shortly before the case was due to go to trial, the Court granted the Indenture Trustee's Motion for Partial Summary Judgment and appointed the Receiver on September 22, 2010 through entry of the Receiver Order.

III. Overview of Actions Taken by Receiver Since Appointment.

Upon appointment, the Receiver's first step was to formulate a business plan to meet the long term goal of having a viable, sustainable, efficient utility serving the needs of the public. According to ESD staff, the 2011 business plan produced under the Receiver's leadership and direction is the first comprehensive business plan ever prepared for the System. Before examining the need for any rate increases, the Receiver's goal was to get the System's internal house in order by identifying where greater efficiencies could be achieved or where improved practices were necessary and to implement plans to achieve those efficiencies and put those practices in place.

The Receiver also began to exercise managerial control over the System. After more than two years of litigation over the appointment of a receiver, criminal prosecutions of County Commissioners, ESD officials, and others, and constant public scrutiny, one of the Receiver's first actions was to meet with employees of the ESD and to assure them that his first priority was to work with them to provide the experience, resources and tools necessary to operate the System as a successful wastewater utility. From an operational standpoint, the Receiver has attempted to instill a new sense of pride within ESD with the goal of operating as a professional utility dedicated to providing high quality, reliable customer service and protection of the environment.

While the Receiver reviewed a significant amount of information in the preparation of the Special Masters Report, his role as one of the Special Masters was limited to investigation and making recommendations to Magistrate Judge John Ott with respect to disputes among the parties in the federal action concerning the operation of the System. As acknowledged in the Special Masters Report, "[t]he specific recommendations were developed based on limited due diligence of [ESD's] operations, input from the County finance department, review of selected consultant's reports issued over the past seven years, and input from the parties involved in the current litigation."[153]

The Receiver's responsibilities far exceed the limited Special Master role. In effect, ESD is similar to a distressed corporation that has retained a new CEO to take over, evaluate all components of the company's operations, and implement changes to chart a new, efficient, and successful course for the business. In doing so, the Receiver met with ESD employees and County officials to obtain a full understanding of the current state of affairs of the operation of the System, including actions taken since the Special Masters Report. Prior to the Receiver's appointment, ESD management had made progress towards implementing some of the recommendations of the Special Masters Report that were within ESD's control, and that progress has continued under the Receiver's direction.

[153] Special Masters Report at 1.

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc Exhibit C - Part 5 Page 1 of 12

Shortly after appointment, the Receiver began the process of conducting a comprehensive review of System operations to identify areas where additional actions were needed for proper financial, administrative, and operational performance as well as where additional efficiencies could be achieved, and to formulate plans to implement changes and other best practices. This review and planning process was generally divided into two main areas: (1) operations and maintenance; and (2) capital investment. The following is a summary of the significant review and planning activities within those two areas.

A. Operations and Maintenance Budgeting and Review Process.

The Receiver implemented a review of System operations and maintenance ("O&M") activities to identify areas where operations were not being performed in accordance with regulations or industry best practices and to assess opportunities for savings to be implemented through improved operating and management efficiencies. The Receiver also directed and oversaw the preparation of a budget for future O&M costs over the next five years. O&M costs include all costs necessary to meet the System's service obligations. Major O&M cost items include salaries and benefits; materials cost; utilities expense; and contractual service costs. A summary of the O&M plan created as a result of this review process is included in the Appendix at A-14.

Due in part to the range of operational efficiencies implemented since the February 2009 Special Masters Report, total System O&M costs have been reduced and are projected to decrease further in the near term, from approximately $62.9 million in 2011, to approximately $58.4 million by 2013.[154] From 2013 forward, total O&M costs are projected to increase each year with inflation, nearly returning to the 2011 level of $62.9 million by 2016.[155] As a distressed utility, a number of necessary O&M best practices have not historically been performed within the System. These necessary practices are identified in the System's O&M plans with associated costs. These added costs have and will continue to offset some of the savings which are being achieved through management and operating efficiencies.

The following sections describe various components of the O&M review and planning process.

1. Personnel Plan.

In November 2010 the Receiver initiated a four-month review of System operations at the organization, division, and individual position levels to assess the System's core functions and determine the personnel needed to achieve those functions. This review primarily focused on treatment operations, the largest division from a staffing perspective. As part of this process, American Water was engaged to assess operations in the System's wastewater treatment plants and plant maintenance divisions, with particular focus on the Village Creek and Valley Creek wastewater treatment plants. American Water is the largest investor-owned water/wastewater utility in North America serving approximately 15 million people. American Water owns and operates approximately $11 billion in assets and operates over 1100 treatment plants. A copy of

[154] B&V Cost Allocation Study at 8, Table 3-1. The B&V Cost Allocation Study is discussed in more detail in Section VI *infra*.
[155] *Id.*

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc Exhibit C - Part 5 Page 2 of 12

American Water's report is included in the Appendix at A-15. American Water was asked to make recommendations for plant operations staffing, implementation of best practices, training and development, and maximizing use of the Supervisory Control and Data Acquisition System ("SCADA"), the plants' existing automated system for monitoring and control over treatment plant operations.

Under the Receiver's direction, ESD used the results of the internal and American Water reviews to create a five-year personnel plan. Since the Special Masters Report, ESD had reduced staff by 50 employees, and the Personnel Plan identified an additional 86 employee positions that could be eliminated (from a total of 456 employees to 370 employees) by the end of the five-year period of the Personnel Plan, for a total reduction in System staff of 136 employees. Savings in personnel expenses associated with eliminating 86 positions will amount to $3.9 million per year by the end of the five-year period. The following is a summary of some of the Personnel Plan actions being implemented.

- Greater efficiencies will be achieved through a combination of internal reorganizations, increased use of contract services, and a greater reliance on technology.

- In the past, treatment plant operating philosophy has been very reliant on direct human observation and interaction, with limited reliance on SCADA. In order to achieve significant reductions in operating expenses, a large-scale plan is currently underway to increase reliance on SCADA and automated treatment plant processes.

- Projected staffing reductions at the treatment plants are the result of a change in philosophy for plant operations to ensure that plant staff are focused only on the core missions of monitoring and responding to daily operations. Non-routine and non-core functions such as grounds and building maintenance, painting, and non-routine heavy equipment maintenance (such as digester cleaning) will be outsourced via contracted services.

- Pump station personnel will be reduced by restructuring inspection routes, reductions in crew sizes, capital improvements to improve redundancy and reliability and increased reliance on remote electronic monitoring of pump stations.

- Equipment reliability will be improved through a combination of capital projects and more efficient internal maintenance to eliminate the time staff is currently required to spend monitoring unreliable or poorly designed systems.

Some identified challenges within the Personnel Plan include:

- County Personnel Board Rules: Over 90% of ESD personnel are merit system classified employees subject to the rules, regulations and jurisdiction of the Jefferson County Personnel Board, which regulates actions and rules for appointments, dismissals, suspensions, reductions-in-force, sick leave, leave of absence, resignation, promotion, demotions, transfer, salary adjustments, and other terms of employment.

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 3 of 12

- Classification and Compensation Levels: As a result of the Personnel Board Rules, ESD is severely limited in its ability to independently establish employee classification and compensation levels, to reward exceptional job performance, rapidly adjust to changing market conditions, and effectively attract qualified employees.

- Job Description, Discipline and Termination: Personnel Board job descriptions limit the ability of employees to perform a greater variety of tasks, and the employee disciplinary and termination process is highly structured and subject to multiple levels of employee appeals, which limits ESD's ability to promptly correct or remove under-performing employees, and may cause delays and or significant legal expenses to be incurred.

- Reductions in Force: Any reductions in force are strictly seniority-based, so staffing reductions contemplated by the Personnel Plan must be executed with little, if any, regard for employee performance, experience, or expertise.

- Outsourcing: Personnel Board rules also require approval of out-sourcing of current functions through contracting, which may prevent ESD from achieving the efficiencies contemplated in the Personnel Plan. The bid responses will determine whether the planned outsourcing is economically justified.

- Overtime: Planned reductions in staffing may increase the System's overtime expense.

- Capital Improvements: Staffing reductions that are dependent on capital improvements in instrumentation, automation, and processes may be delayed if the improvements are not funded and completed as planned.

2. Review and Validation of the Accuracy of Billing and Collection Practices.

One of the most fundamental requirements for an efficient, financially sustainable wastewater utility is the need for an accurate and reliable system for billing and collecting wastewater service fees. As noted in the Special Masters Report, ESD depends heavily upon BWWB, Bessemer Utilities ("Bessemer") and several other water utilities for various aspects of its billing and collections program. Upon assuming control of the System, the Receiver learned that ESD had never performed an audit or any other investigation to verify that the amounts billed and collected by BWWB, Bessemer and the other billing water providers were correct. One of the first things the Receiver did was to start the process of verifying these billed and collected amounts.

SAIC Energy, Environment & Infrastructure, LLC ("SAIC"), formerly R.W. Beck, was asked to perform a desk audit of ESD's sewer revenue reports, records, and data available from previous work. SAIC is an engineering company focused on providing design, construction, and operational advice to public and private infrastructure organizations, including utility providers.

Following receipt of the desk audit report, SAIC was requested to prepare a proposal to conduct a more detailed analysis of the integrity of the billing and collection procedures that generate the majority of the System revenues. On April 21, 2011, SAIC was authorized to

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 4 of 12

proceed with its proposed detailed analysis. In addition to collecting various data, an initial series of interviews were planned. However, the interviews were delayed as a result of the tornado damage that occurred in the County and throughout Alabama.

Interviews were conducted during the week of May 16, 2011 with ESD personnel and representatives from BWWB and Bessemer. The interviews covered a number of issues with particular focus on the policies and practices each water utility follows to ensure all customers receiving wastewater services from the County are being properly billed for those services. The importance of this item, which was identified in the Special Masters Report, is exemplified by the fact that between May 2009 and November 2010, ESD personnel discovered 317 instances where wastewater service was being received, but bills were not generated to cover the service. The annual revenue associated with those accounts, which are now being billed, is approximately $3.15 million.

Other elements of the SAIC project involve the following:

- analysis of audit reports issued to BWWB and Bessemer with follow-up to identify any weaknesses in policies or practices that could impact ESD revenues;

- examination of internal controls within ESD;

- examination of a statistical sample of customer accounts to determine whether bills are being issued and calculated correctly; and

- review of water meter maintenance and testing policies and practices by each water utility to assess the accuracy of water usage data used to calculate wastewater service bills.

A report on the findings from the SAIC project is expected to be received during summer 2011. The findings from the project will be used to develop new or improved policies and procedures to improve the accuracy of the billing process and ensure that proper revenue is being received from our contract billing providers. In addition, a more efficient method for identifying customers who are receiving sewer service without being billed will be developed and implemented.

3. Improving Customer Billing and Collection Practices.

During interviews with BWWB and Bessemer, in conjunction with the SAIC review of billing and collection practices, it was learned that both utilities are planning to implement new billing systems within the next two to three years. BWWB has expressed a desire to discontinue billing for the County's wastewater service on its water bills.

The existing ESD billing system was developed internally using Common Business Oriented (COBOL) programming language and is administered on the County's mainframe system. The billing system is limited in its ability to accommodate additional customers, but is capable of being expanded to accommodate the number of customers now being billed by Bessemer. It is not capable of being expanded to accommodate all of the customers currently being billed by BWWB. Moreover, the County plans to replace its mainframe-based system in

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 5 of 12

the next two years, which will require a new billing system. Therefore, a new billing system must be procured and implemented as soon as possible. While necessary, establishing a new billing system will involve an increase in System operating costs (that are not currently in the System's budget) as additional capital will be required to purchase and set-up the new system. Bringing the billing services in-house may, however, generate savings in reduced billing costs over the long term.

When ESD achieves the capability to issue bills to all of its own customers it will still need to maintain close working relationships with the water utilities that provide water service to ESD's customers. Water usage is the industry standard for calculating wastewater user fees, and will continue to be a significant basis for calculating ESD's bills for wastewater service, and all of the utilities will need to work together to assure customers receiving service are properly recorded as customers so that bills can be issued. Accordingly, agreements are now being developed to formalize provisions of service between water utilities and the ESD. The agreements will include improved provisions for terminating water service by the water utility upon notification from ESD that a customer is delinquent in paying its wastewater bill.

In the past, ESD's practice in responding to delinquent sewer accounts was to place a lien on the property, which must be paid in full before the property can be sold. Because the lien does not impact the owner's water or sewer service, this practice has done little to alleviate the costs to the System from delinquent accounts.[156] This is evident in the total costs to the System each year from delinquent and uncollectible accounts, which in recent years has averaged 3.5% of total System revenues.[157] These costs to the System are two and a half times larger than the industry standard for delinquent accounts. Current plans to contract with a professional collection agency may aid in reducing the current delinquent and uncollectible costs.

Recent legislative changes, however, may result in increased delinquent and uncollectible account costs. In 2008, the legislature passed and the public approved Amendment 818 to the State Constitution, which prevents the System from placing a lien on rental property occupied by a tenant. Amendment 818 states that in Jefferson County, "any bill for sewer service received in the name of the tenant or tenants shall be the sole responsibility of the tenant or tenants and shall not constitute a lien on the property where the sewer service was received." ALA. CONST. amend. 818. The impact of this legislation further hinders the System's collection of delinquent accounts, and makes the contract shut-off provisions with the billing water provider even more crucial.

4. Fleet Management Procurement.

ESD currently relies on Jefferson County for the procurement, maintenance and replacement of its vehicles and rolling stock as well as for provision of gasoline and diesel fuel. The total cost of obtaining fleet management services from the County is difficult to identify due to the fragmented areas of responsibility and the County's historically poor cost allocation practices. However, there are better practices within the utility industry, which can lower the overall cost while improving efficiencies within ESD.

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[156] Special Masters Report at 3.

[157] B&V Cost Allocation Report at 9. This cost estimate is based upon an analysis of sewer billings versus collections in fiscal years 2009 and 2010. A detailed discussion of these costs is contained in Section VI *infra*.

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc Exhibit C - Part 5 Page 6 of 12

The Receiver has initiated a process to solicit proposals for procurement of necessary vehicles and rolling stock as well as to implement best practices for fuel purchasing and distribution, vehicle maintenance and record-keeping. In addition, the program being bid will include controls to ensure the program is being used as intended.

The bid document is expected to be issued, and bids received, in summer 2011.

5. Legal Expenses.

Legal expenses for the System have been reduced in the near-term, but this remains a potential category for increased System costs in the future. Additional or protracted litigation in the future concerning the Receiver's planned rate increases or other activities could result in a significant increase in System legal expenses above budgeted levels. These potential increases, however, are not expected to rise to the historically high levels of legal expenses incurred by the System in past years.

6. Review of Utility Expenses.

The Receiver and ESD have implemented operational changes intended to improve energy efficiency in several of the System treatment processes. These changes have resulted in reduced projections for the System's total electricity cost, which is the largest category of System utility expenses. In addition, ESD has recently completed a waste gas energy recovery and process optimization study at the Village Creek treatment plant that identifies additional cost saving strategies for that facility. ESD has a contract in place for a similar project at the Valley Creek treatment plant. Preliminary estimates project the energy operating cost savings from these projects to increase to $1.6 million by the end of the five year period. Although additional efficiencies may be achieved through a more detailed analysis of operations in the future, additional savings may be offset by changes in utility prices.

7. Maintenance Management Practices.

The Receiver engaged American Water to conduct a review of ESD's maintenance management practices in the mechanical, electrical, and instrumentation (SCADA) disciplines associated primarily with the System's wastewater treatment plant maintenance division. The review identified certain maintenance activities that were either not being performed, or not being performed in accordance with best industry practices, and recommended a plan for improved maintenance and management of the wastewater assets.

The plan's goal is to establish effective maintenance management, which employs an organized, proactive, and reliability-focused strategy of condition monitoring and preventative and reactive maintenance in a combination that yields optimum asset and process performance, including safety and environmental protection, at maximum economic benefit. This proactive approach will reduce the total life cycle cost of equipment by saving money on equipment repairs and replacement, and will also improve reliability by reducing unplanned outages. American Water also provided a maintenance management training module to train System employees to establish foundational strategies for the maintenance management program.

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 7 of 12

American Water's assessment involved a tour of System facilities and a survey of System employees in order to assess System performance in several key maintenance activities and practices. The survey results indicated most System employees surveyed believed all activities and practices could be improved, with the lack of a formal training program listed as one of the highest priority issues (the County essentially cut all funding for training in 2008). As a result of the survey, a number of prioritized and targeted training and development objectives were created as a starting point for implementing a formal training program.

The survey also revealed a mostly reactive (break and fix) approach to maintenance activity, rather than the preferred reliability-focused approach. A number of asset condition monitoring and assessment programs were recommended to address this concern. Recommendations are now being implemented. Some of the more significant maintenance programs will require service agreements for standby generator preventative maintenance, switchgear inspection, protective relay testing programs, and transformer inspections and insulating oil analysis.

8. Capitalized Labor.

ESD has not capitalized internal labor expenses in the past, but instead expensed one hundred percent of internal labor as an operating cost. Under the terms of the Indenture, and according to Generally Accepted Accounting Principles ("GAAP"), costs related to the addition or replacement of property, plant, or equipment or improvement costs that result in the extension of an asset's useful life should be capitalized, whereas normal maintenance activities should be expensed to operations. Since appointment of the Receiver, ESD has created a formal capitalization policy and begun implementation. Systems have been developed to allow various divisions to capture and track individual work hours and expenditures related to capital improvement. This labor and expense data will be gathered through 2011, and will be used to develop the 2012 business plan when full implementation of the policy and financial adjustments will begin. Proper accounting of capitalized labor is consistent with utility industry best practices and will allow more expenses to be recovered from the System capital recovery account. Proper accounting of capitalized labor will, however, reduce the amount of capital funds.

9. Allocated Costs from the County.

As a division of the County, ESD has traditionally received in-kind services from the County. Allocation of these costs to ESD occurred periodically in the past. The in-kind services traditionally provided by the County to ESD are building space, finance and accounting services, risk management, human resources, legal services from the County attorney's offices, information technology (IT) services, and fleet management. As noted in other parts of this report, it is possible ESD could realize significant expense savings and operational advantages if many of these services are contracted out or performed internally by ESD.[158]

[158] Moreover, if the County transfers the assets of and responsibility for its wastewater system to an independent public corporation as part of a refinancing, that corporation will assume operational and financial responsibility for all in-kind services currently provided by the County. The potential benefits of an independent public corporation are discussed in more detail in Section VIII *infra*.

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 8 of 12

In an attempt to update the basis for its allocation of expenses among all County departments, the County recently commissioned and received a "Full Cost Allocation Plan" for FY2008 by MGT of America (the "MGT Allocation").

However, the MGT Allocation has some flaws. With little explanation, it assesses ESD approximately $8,000,000 for in-kind expenses provided in 2008. The County has asked the Receiver to accept this 2008 amount as the cost allocation for FY 2010. The County has provided no basis for the assumption that FY 2010 costs were equivalent to those incurred in FY 2008. Among other reasons, because of the 2008 meltdown of the County's finances, 2008 expenses are in no way indicative of actual 2010 ESD expenses. Moreover, the MGT Allocation improperly assesses costs to ESD for the County Commission department, even though ESD does not have a County Commissioner overseeing its functions; all ESD functions are directed by the Receiver. The Receiver has other concerns about the MGT Allocation and has declined to agree to the County's request or accept its proposed allocation. The Receiver will continue to work with the County towards a reasonable allocation for FY 2010 costs, as well as those incurred in FY 2011 and thereafter. For planning purposes, the Receiver has included the current $8 million allocation in the business plan, so resolution of this issue with County provides an opportunity for additional cost savings to the System.

B. Capital Improvement Plan.

The Receiver also directed the preparation of a System Capital Improvement Plan ("CIP"). A copy of the CIP is included in the Appendix at A-16. The purpose of the CIP is to provide a multi-year forecast of the capital investment required to provide an adequate level of systematic major repairs, replacements, and improvements necessary to maintain compliance with Consent Decree and NPDES requirements, to sustain the efficient and reliable operation of the System, and to provide meaningful data to be incorporated into ESD's financial and business planning process.[159] Prior to the County's 2008 default under the Indenture, ESD's projected total capital investment from 2009 to 2011 was approximately $70 million, or approximately $24 million per year. However, actual investment in the System since 2008 has totaled only $25 million (approximately $8 million per year), a historical low for the System in recent history.

There are generally two types of capital expenditures: maintenance capital expenditures ("Maintenance Capex") and project-based capital expenditures ("Project Capex"). Maintenance Capex refers to routine investment necessary to renew and replace existing assets and maintain the reliability and efficiency of the existing system; Project Capex refers to investment necessary to expand or improve the System to keep pace with growth or regulatory requirements. The CIP proposes to reverse the historic pattern of inadequate investment in the System. The level of Maintenance Capex is based on an average asset life for buried infrastructure of 100 years, reflecting an annual renewal rate for those assets of 1% per year.[160] Bringing the Maintenance Capex level to this annual renewal rate is appropriate given the condition of the System. However, that level of Maintenance Capex may not be sufficient to control sanitary sewer

[159] In 2003, the County's consultant BE&K estimated that an additional $246 million (in 2003 dollars) would be needed to repair known defects in the System following termination of the Consent Decree. BE&K Report at 2-13. The BE&K Report is discussed in more detail in Section II.C.1 *supra*.

[160] American Water Works Association ("AWWA"), *Benchmarking Performance Indicators for Water and Wastewater Utilities: 2007 Annual Survey Data and Analyses Report.*

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 9 of 12

overflows ("SSOs") at a level to avoid all future regulatory enforcement actions and the need for additional capital investment. The Receiver will continue to monitor and adjust System plans as necessary to maximize regulatory compliance.

The CIP also includes an average of about $15 million per year in Project Capex, for a total annual capital investment of approximately $35 million per year for the next five years. Although the CIP is based on the best information currently available, future hydraulic modeling may identify the need for additional investment to address capacity issues. Due to the current financial demands on the System, the CIP is designed with the assumption that capital projects will be financed through the approximately $240 million in existing capital reserve funds. After exhaustion of those revenues, capital projects will be funded through System revenues, provided the current debt is refinanced.

The CIP consists of a near-term five-year plan and long term ten-year plan. The five-year plan includes specific projects identified as necessary, with corresponding budget estimates, planned start and completion dates, and descriptions of work. The fifteen-year plan is divided into fifteen categories of work, with corresponding estimated annual costs for each category based on the known needs of the System together with EPA and state regulatory requirements, industry best practices, and industry benchmarks. The categories can be grouped into five classifications: Asset Management, Asset Renewal, Capacity Improvement, Expansion, and Regulatory Compliance.

The Regulatory Compliance category includes improvements and modifications necessary to meet the Alabama Department of Environmental Management ("ADEM") revised treatment standards for phosphorus levels in the Cahaba River watershed. ADEM has determined that phosphorus levels in discharges to the Cahaba should be reduced and has proposed that phosphorus discharge levels be decreased in three stages. The System will be able to achieve the phase one and two treatment levels through modifications to treatment processes and facilities that may cost the System up to $20 million. However, achieving the phase three treatment level of .043 parts per million will require approximately $150 million of improvements beginning around 2021. The CIP incorporates estimated costs for these improvements, but the Receiver is currently negotiating with ADEM to defer these improvements or narrow the scope of what will be required. If these negotiations are successful, additional cost savings in the current CIP may be achieved.

As previously discussed, despite the improvement plan to comply with the Consent Decree, the System continues to experience approximately 280 overflows per year, each potentially carrying a $1000 penalty.[161] The overflows are mostly maintenance-related and caused by blockages related to the accumulation of grease and sewer pipe collapses. In its work for the Receiver, Black and Veatch ("B&V")[162] estimated total System inflow and infiltration ("I&I") by comparing the total amount of adjusted metered water consumption for all System

[161] The overflow problems are also discussed in Section II.C.1 *supra.*

[162] B&V is a leading global engineering, consulting, and construction company with extensive experience in water, energy, and other utility infrastructure construction and consulting projects. B&V also has significant experience advising utilities and financial services companies on the financing and operational aspects of utilities and has advised numerous wastewater utilities and water providers on the establishment of rates. The Receiver engaged B&V to perform certain financial and rate analyses. Those analyses are discussed in Section VI, *infra.*

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 10 of 12

customers versus the total volume of water treated by the System's treatment plants. This comparison resulted in a finding that approximately 64% of the water treated by the System on an annual basis was due to I&I. Stated another way, 64% of the water treated by the System came from sources other than customer use (e.g., from ground water seeping into pipes, storm water leaking into manholes, illegal connections to sewer lines, etc.). By comparison, typical wastewater systems should only experience I&I of between 30-35%. The I&I experienced in the System greatly adds to the costs needed to treat the wastewater flowing through the System. The CIP is designed to address this significant I&I problem.

Other major elements in the five-year plan within the CIP center on the following categories and needs:

- cleaning and television inspection projects to determine existing conditions and reduce blockages;
- flow monitoring, modeling and engineering to identify existing and future condition and performance deficiencies;
- correction of known problems and failures (sanitary sewer overflow abatement, sewer replacement, facility repair, and pump station upgrade projects);
- optimization and automation projects and other improvements to improve reliability and reduce operating costs;
- regulatory compliance improvements;
- regular system reinvestment (capital equipment and rehabilitation, repair, replacement, and renewal projects); and
- expansions of the System when business case evaluations justify the investment.

The System currently has approximately $240 million in reserve funds available for capital expenditures. It is worth noting that, if a solution to the debt crisis is not found which provides for replenishment of the System's existing accounts, the System will run out of funds for capital expenditures, probably in 2016. Under the Indenture, System Revenues may not be used to fund capital expenditures until all debt service costs are paid. Therefore, rates would have to be increased to a level sufficient to cure all defaults and cover the significantly-increasing debt service costs. This is almost certainly not feasible.

The System would essentially have to discontinue its capital program or rely on funds from the County or State. If capital expenditures were eliminated or severely cut back, the System's assets would begin to deteriorate, which would likely result in public health and environmental problems. Moreover, the financial responsibility for complying with the Consent Decree and CWA would fall on the County and, possibly, the State.

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 11 of 12

C. The Receiver's Efforts to Work Towards a Negotiated Solution to the Sewer System Crisis.

The Receiver has held numerous meetings with various stakeholders, including business and community leaders, local elected officials and state legislators, various creditor groups, EPA officials, and others interested in finding a solution to the debt dilemma the System faces. One point is clear, and has been for some time – the best path to an ultimate solution is a negotiated settlement between the all the various creditors groups and the County.

The Receiver has also attempted to facilitate communications between the County and its various creditors groups and among the different creditor groups in an attempt to develop a mutually-agreeable strategy for a negotiated solution to the sewer debt default. There are four major creditors groups: (1) JPMorgan; (2) the bond insurers; (3) the Liquidity Banks; and (4) the pension funds, hedge funds, individuals, and other investors that hold the warrants, who are represented by the Trustee. All of the various members within these creditors groups have different levels of involvement in the County's past financing structures. Some of the individual creditors have been accused of wrongdoing, while others have not. Some of the individual creditors, including various bond insurers and Liquidity Banks, have agreed temporarily not to exercise the remedies they are entitled to under the County's agreements, and are currently in forbearance, while other creditors have yet to make such agreements. Each of the members of the various creditors groups has a different perspective and different priorities with regard to a potential negotiated solution.

The task of facilitating negotiations among and between the County and the various creditors groups has been and remains challenging, largely due to the long-standing adversarial relationship that exists between all parties as a result of the litigation associated with the County's default and the numerous on-going civil lawsuits between several of the parties.[163] In an attempt to enhance these relationships and open communication, members of the County Commission (David Carrington and Jimmie Stephens) and the Receiver traveled to New York during late January 2011 to meet with several of the major creditor groups – JPMorgan, the bond insurers and several of the Liquidity Banks. These meetings helped the parties understand the expectations of the County and each of the major creditor groups, although it is fair to say that they did not materially enhance prospects of a settlement.

Additionally, to help direct the financial negotiations towards a feasible solution, the Receiver worked with Citigroup Global Markets, Inc. ("Citi"), a leading municipal bond expert, to prepare financial analyses to assist the Receiver in determining the net sewer revenues required to satisfy a wide range of sewer debt levels.[164] In the analyses, Citi provided interest

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[163] There are at least three significant and active pieces of litigation related to the System and its financing: (1) *Jefferson County, Alabama v. J.P. Morgan Securities, Inc., et al.*, Circuit Court of Jefferson County, Alabama, Case No. CV-2009-903641; (2) *Wilson, et al. v. J.P. Morgan Chase & Co., et al.*, Circuit Court of Jefferson County, Alabama, Case No. CV-2008-901907; and (3) *Syncora Guarantee, Inc. v. Jefferson County, Alabama, et al.*, Supreme Court of New York County, New York No. 601100/10.

[164] Citi performed the calculations set forth in this report upon the request of, and based on assumptions provided by, the Receiver. Citi received no fee or non-monetary compensation for such calculations and has not been engaged by the Receiver or the County in any capacity. Citi has not assumed a fiduciary responsibility with respect to the matters set forth in this report, and nothing in this report or in any prior relationship between Citi and either the Receiver or the County will be deemed to create an advisory, fiduciary or agency relationship between Citi and the

Case 11-05736-TBB9 Doc 45-4 Filed 11/10/11 Entered 11/10/11 10:24:27 Desc
Exhibit C - Part 5 Page 12 of 12